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SUBJECT: ANOTHER MERCOSUR SUMMIT WITH FEW CONCRETE RESULTS

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Classified By: A/DCM Bruce Kleiner; Reasons 1.4(b),(d)

[1](#)1. (C) SUMMARY: Paraguay hosted the 33rd Mercosur Summit on June 29 and passed the rotating Mercosur Presidency to Uruguay. Six regional presidents attended from Brazil, Argentina, Uruguay, Bolivia, Ecuador and Chile and endorsed a 38-point Declaration offering form but little substance. Venezuela's President Chavez declined to attend as he had a prior commitment in Iran and sent Vice President Jorge Rodriguez in his stead. President Chavez's absence made the Summit less of a spectacle than in the past, although peripheral events made the Summit more interesting. Paraguay's bilateral meetings with Brazil and Argentina yielded agreements on a tax regime and dam cooperation. An alternate "Summit" attended by 1,500 individuals calling economic reform, comments by opposition presidential candidate Fernando Lugo in Spain, and a gaffe by President Duarte added to the intrigue. END SUMMARY.

WHAT THE PRESIDENTS SAID

[1](#)2. (U) The Summit participants emphasized a wide range of issues in their formal remarks. Paraguay's President Duarte spoke about the importance of strengthening and consolidating Mercosur despite its many critics. He emphasized the importance of reducing barriers to the free flow of goods and people within the bloc and expressed support for greater energy integration. Uruguay's President, Tabare Vazquez, announced that the free circulation of goods and people as well as the reduction in asymmetries within the bloc would be Uruguay's priorities during its term as Mercosur President. President Lula admitted that Mercosur had not met founding members' expectations and lent support to efforts to address asymmetries among members. He also urged members to embrace biofuels. President Kirchner of Argentina emphasized energy cooperation in the face of recurring crises. He acknowledged economic differences among members but noted that large discrepancies also exist internally within member states.

14. (U) Chile's President Bachelet spoke to the importance of addressing climate change within Mercosur as well as encouraging sustainable forestry. Ecuador's President Correa urged the creation of a Monetary Fund of the South that would pool the foreign reserves of South American countries with the eventual goal of moving toward a single currency and mitigating the need to rely on international financial institutions in times of crisis. He also emphasized the importance of the creation of Banco del Sur. Bolivia's President Morales challenged Mercosur to concentrate on social issues and -- without naming names but clearly referring to Brazil and Venezuela -- called for nations in the region to lay aside their differences and avoid competing for regional hegemony. President Morales also called for greater regional energy cooperation. Venezuelan Vice President Rodriguez urged members to deemphasize commercial issues and focus more attention on poverty reduction, sovereignty, and the rightful possession of natural resources by the people.

THE OUTCOMES

15. (U) The Mercosur Summit Declaration (Ref A) offers 38 points ranging from human rights to energy. Few, however, relate to economic issues. Paraguay benefited from the extension until 2022 of a 40 per cent Mercosur content requirement for products sold as internal goods within the bloc. Products produced in Brazil and Argentina must use at least 60 per cent Mercosur content to qualify as internal goods, encouraging them to import content from smaller, less-developed members such as Paraguay. The Common Market Committee agreed to come up with a plan by January 2008 to improve the free flow of goods between members. The members agreed to establish a fund to aid small- and medium-sized enterprises (PYME), which should benefit Paraguayan businesses. The Declaration acknowledged structural differences and committed the Mercosur to focusing further on increasing market access for goods produced by Paraguay. Paraguay could potentially benefit from members' commitment to energy integration as it seeks to capitalize on its potential biofuel -- sugar-based ethanol and biodiesel -- capacity. Finally, the Declaration formally thanked Paraguay for hosting the Summit.

AGREEMENT ON TRI-BORDER TAX REGIME

16. (U) During the Summit, Brazil and Paraguay held a concurrent bilateral meeting and reached agreement on a new tax regime that would apply a 25 per cent tax rate to the so-called "sacoleiros" who earn their living transporting, often by foot, merchandise purchased in Ciudad del Este (CDE), Paraguay across the Friendship Bridge to Foz do Iguazu, Brazil. A tax agreement has been a high priority for Paraguay as a way of increasing tax revenues and formalizing the informal work force that facilitates much of the commerce between the two cities. The tax regime will go into affect once ratified by both countries. Paraguay preferred a tax rate closer to 18 per cent, but Brazil insisted on a rate just over 50 per cent. The two countries compromised at the 25 per cent level, a level acceptable to the Paraguayans but possibly too high to encourage "sacoleiros" to register and pay the tax. Astrid Weiler, former Director of Intellectual Property and now an advisor to the Tax Administration on CDE formalization efforts, told EconOff that time would tell whether the new rate leads to the desired outcome. The GOP had estimated that a rate over 22 percent would render the legal route uncompetitive, but Weiler stated that the proof would be in the number of individuals who choose to sign up if the plan is implemented. The biggest hurdle will be ratification of the agreement by Brazil's Congress. The agreement partially fulfills a commitment made by President Lula during his official visit to Paraguay in May. Paraguay's Foreign Minister told the press that President Lula had also promised to negotiate special state tax rates

within Brazil, since it would be considered a federal tax in Brazil.

TECHNICAL LEVEL REACTION -- NOT MUCH PROGRESS

¶17. (C) EconOff met with several Ministry of Foreign Affairs (MFA) officials, including Didier Olmedo, the MFA's Director-General of Economic Policy and the GOP's chief technical-level coordinator of Mercosur issues. Olmedo repeated negative sentiments expressed in reftel with respect to Venezuela, which MFA officials see as aspiring to first achieve membership to the club without first negotiating the terms. They complained that Venezuela has rejected the base agreements underlying Mercosur and has refused to name specific tariff lines they would adjust each year as part of Mercosur's entry process. For these MFA officials, Mercosur would be better off if Venezuela were to withdraw its request for full membership as Chavez threatened while visiting Iran.

¶18. (C) Olmedo and his advisor, former Vice Minister of Industry Raul Cano, also a career diplomat, expressed pessimism about the outcomes of the Summit. They acknowledged the diffuse nature of the Summit's declaration and the lack of tangible progress towards a freer flow of goods within the bloc, Paraguay's first priority. The extension of the forty percent rule until 2022 is positive, but it is not enough to attract investment to Paraguay if investors face uncertainty about what sorts of obstructions and non-tariff trade barriers they will face if exporting to Brazil or Argentina.

¶19. (C) Olmedo commented that Brazil was "against the ropes" in the meeting of the Common Market Committee, since all the founding members of Mercosur have complained about Brazilian protectionism. Another sore spot is Brazil's aggressive use of what Paraguay considers unfair incentives to attract investment. One example is the free trade zone in Manaus. Cano claimed that goods effectively subsidized with tax breaks enter Manaus or are produced there but end up in other Mercosur countries, while Brazil makes it difficult for goods to flow the other way. Olmedo enjoyed a comment made by Uruguayan Finance Minister Astori in the meetings in which he reportedly told his Brazilian counterpart that if Brazil insisted on non-conforming flexibility, then Uruguay would also pursue its own flexibilities with respect to trade agreements outside the bloc.

¶10. (C) In a separate meeting, Vice Minister of Commerce Guillermo Alcaraz expressed similar skepticism about the outcomes and the chance that Brazil's bureaucracy will act on President Lula's conciliatory words about greater integration. On the bilateral agreement with Brazil aimed at creating a special regime for the "sacoleiros," Alcaraz suggested that the Federation of Industries of the State of Sao Paulo (FIESP), a powerful commercial association, would successfully fight attempts to improve access to Brazil's market. Alcaraz also admitted that no funds from the Mercosur Structural Convergence Fund (FOCEM) had made it to Paraguay to date, but he was optimistic that Paraguay would see part of the promised assistance by year end.

THE ALTERNATIVE SUMMIT

¶11. (U) A small alternative summit took place near the venue of the Mercosur Summit with the reported participation of about 1,500 individuals. The "Summit of the Peoples of the South" called for the renegotiation of the bilateral agreements for the Itaipu (shared with Brazil) and Yacyreta (shared with Argentina) hydroelectric plants. The group also called for greater equity for rural farmers displaced by large agro-industrial operations, particularly those related to soy cultivation. At one point, a group reported to number about 500 caused some disturbances with police as they tried to approach the Mercosur Summit venue.

A NEW DAM?

¶12. (U) Press reports indicated that Presidents Duarte and Kirchner agreed during the Summit to work toward completion by the end of 2008 of the complimentary works needed to raise the reservoir level of the existing Yacyreta dam (and thus increase its energy output by about a third). They also agreed to begin work on a third major bi-national dam commonly known as Corpus that would be located on the Parana River upstream from Yacyreta but downstream from the Itaipu Dam shared with Brazil. The new dam would reportedly cost USD 4.5 billion and would be financed by Argentina.

PRESIDENTIAL CANDIDATE LUGO'S ROLE MODELS

¶13. (U) The press reported comments made on June 29 by presidential candidate Fernando Lugo in Spain expressing his admiration for the presidents of Venezuela, Bolivia, and Ecuador for their courage to "make breaks with the past." Lugo said he believes Paraguay needs a break with the past as well, but in its own way and without copying the experiences of others. Lugo has proven reluctant or unable to articulate a policy platform, preferring instead to say that he is "listening to the people" while on a tour that took him to the United States, Argentina, and Spain.

A SMALL GAFFE?

¶14. (U) The press highlighted a comment in Guarani made by President Duarte while President Bachelet spoke about the importance of addressing global warming. He reportedly commented to his Agriculture Minister that she was "speaking nonsense" but didn't realize there was an open microphone nearby. The Foreign Ministry issued a clarification and contacted the Chilean Ambassador claiming that Duarte was referring to something the Agriculture Minister had said about the Alternative Summit participants.

COMMENT

¶15. (C) The Summit yielded few tangible outcomes, although the Declaration and bilateral meetings offered Paraguay potential economic benefits. The concerns expressed by MFA officials are valid, because the benefits depend on whether Brazil, Argentina, and Mercosur fulfill their commitments. Paraguay has had a difficult time getting positive results from Mercosur, largely as a result of insufficient access to Brazilian markets. However, the country continues to remain in the bloc and seek any benefit it can. The tax agreement with Brazil for a 25 per cent levy on the sacoleiros is a positive step, but the regime must still be approved by the two countries and demonstrate that it can adequately regulate the informal Triborder economy. Paraguay and Argentina's agreement to cooperate further on dams could also benefit the country through additional electricity and revenue generation. Mercosur's acknowledgement of economic disparities between members could aid Paraguay in the long run, although future summits would first need to address these disparities. The country demonstrated its ability to coordinate a major event. If nothing else, Paraguay's status as host directly benefited the local economy and helped improve its standing in Mercosur.

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